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SA/RR file

CENTRAL INTELLIGENCE AGENCY  
CODEWORD ROUTING SHEET

TO		INITIALS	DATE
1	Chief, M/ME	<i>W</i>	18 Dec 62
2	Chief, D/M	<i>WMP</i>	19 Dec 62
3	Ch/E	<i>Eta</i>	20 Dec
4	SA/RR	<i>WMP</i>	26 Dec
5	<span style="background-color: black; color: black;">[REDACTED]</span> 25X1A9a	<i>WMP</i>	26 Dec
6			
FROM		INITIALS	DATE
1	25X1A9a <span style="background-color: black; color: black;">[REDACTED]</span> M/ME	<i>air</i>	18 Dec 62
2			
3			

☐ Approval      ☐ Information      ☐ Signature  
☐ Action      ☐ Direct Reply      ☐ Return  
☐ Comment      ☐ Preparation of Reply      ☐ Dispatch  
☐ Concurrence      ☐ Recommendation      ☐ File

## REMARKS:

*TS codeword material derived  
 from data in CIA/RR SC 59-12, referred  
 to [REDACTED] 25X1X7*

APPENDED DOCUMENT CONTAINS CODEWORD MATERIAL

Appended document contains classified information within the meaning of Section 798, Title 18, United States Code.

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26 DEC 1962

Memorandum No. 5036-S  
25X1A9a

MEMORANDUM FOR: [REDACTED]

SUBJECT: Response to [REDACTED] Questions 25X1X7

25X1X7

1. When [REDACTED] was here at the end of October, he asked some questions about military expenditures. Because of the "Cuban Crisis" we were not able to get to them until now. He wanted to know our opinion of: (a) whether the Soviet defense-associated industries operate on a "cost-accounting" basis or whether they are "subsidized"; (b) the effect on military costs of the forthcoming revision of Soviet wholesale prices for basic materials.

2. The attached paper addresses itself to these questions, but more important, it also attempts to contrast the [REDACTED] and 25X1X7 GSR approaches to the problem of measuring military expenditures. This should be helpful in understanding whatever differences in interpretation may arise in the future.

25X1A9a  
[REDACTED]

Attachment  
a/s

Distribution:

Orig. & 2 -- Addressee  
1 -- SA/RR  
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ORR:D/M/ME:AAE:ram/5238 (18 Dec 62)

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GROUP 1  
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downgrading and  
declassification

HANDLE VIA COMINT CHANNELS

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~~TOP SECRET DINAR~~ATTACHMENTThe Defense Budget

25X1X7

Notwithstanding that the costing done by [REDACTED] and by ORR seemingly encompass expenditures reasonably comparable to the major national security expenditures of the US, they differ in a fundamental manner. [REDACTED] accepts the Soviet allocation Defense as embracing all direct Soviet military expenditures except for those associated with military research and development, militarized security forces, all military pensions, DOSAAF, and very probably military stockpiles. ORR agrees that these activities are probably not financed (at least in very large part) from the allocation Defense, with the possible exception of pensions for retired career personnel. Moreover, ORR believes that this allocation cannot be accepted as necessarily providing the financing for all other military programs and activities; if anything, the available evidence suggests that it falls significantly short of doing so, particularly prior to mid-1961. This available evidence is with one exception not new -- the Soviet system of classification of military accounts, the apparent size of the financing for state reserves, the ambiguity of Soviet definitions of the allocation Defense, and the suggested size of the military machinery residual derived from Soviet figures on industrial production. Although this evidence is not conclusive given its incompleteness and/or the ascribable margins of error, it is consonant with the estimates of Soviet military expenditures made by ORR through detailed costing of the various programs and activities of the Soviet military establishment.

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(It is worth noting that these estimates could be significantly understated with respect to certain programs because of the possibility of omitted items or the application of prices that are too low.)

Interestingly, the increase in military expenditures announced in mid-1961 by the USSR also tends to suggest the same thing. Analysis indicates that it is highly unlikely that the USSR was able to expend an additional 3.1 billion rubles during the applicable last six (6) months of the year nor was there evidence of stepped-up programs that could account for very much of it. Ergo, the judgment has been that much of the announced increase, perhaps as much as two-thirds, was a bookkeeping change -- a surfacing of expenditures previously financed from other sources. Of those expenditures that both [REDACTED] and OSR agree are financed from other sources only research and development could account for such a magnitude. However, the allocation for science has continued to increase in its own right...\*

In this same regard, examination of OSR's estimates is of some interest. The tabulation that follows indicates that when expenditures for RDT&E, militarized security forces, and DGBAAF are eliminated from total expenditures, the expenditures in 1960 are 12.3 billion rubles, in 1961 12.9 billion rubles, and in 1962 14.1 billion rubles. The estimate is 3 billion rubles greater than the published expenditure for 1960; 3.6 billion

\* Depending upon the definition of stocks, they too are a possibility. However, there is a suggestion of the same argument as is here made with respect to R&D.

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## Soviet Military Expenditures

Billion New Rubles <sup>a/</sup>			
	<u>1960</u>	<u>1961</u>	<u>1962</u>
<b>A. Estimated expenditures</b>			
1. Strategic attack mission	2.03	2.23	3.02
2. Air defense mission	1.85	2.36	3.02
3. Ground mission	4.58	4.39	3.94
4. Naval mission	1.60	1.60	1.81
5. RDT and E	2.70	3.20	3.70
6. Command and Support	1.53	1.51	1.49
7. Pensions for retired career personnel	0.36	0.37	0.38
8. Militarized security forces	0.32	0.29	0.29
9. Reserve personnel	0.40	0.41	0.41
10. DOEAAF	0.05	0.05	0.05
11. Total <sup>b/</sup>	<u>15.4</u>	<u>16.4</u>	<u>18.1</u>
12. less 5, 8, 10	12.3	12.9	14.1
<b>B. Published allocation Defense</b>	9.3	11.6 <sup>c/</sup>	13.4 plan
<b>C. <math>\triangle</math> A-12 - B</b>	3.0	1.3	0.7
<b>D. C as % of A. 12</b>	24	10	5

a. Estimated expenditures in terms of 1955 prices, published expenditures in current prices. Although the estimated and published expenditures are compared without benefit of adjusting for price differences, no appreciable error is believed introduced; applicable price changes since 1 July 1955 are believed modest.

b. Components may not add to totals because of rounding.

c. Original plan 9.3; modified plan 12.4.

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rubles greater than the plan figure originally published for 1961, only 0.5 billion rubles greater after the announced mid-year increase, and 1.3 billion rubles greater than actual expenditures; and 0.7 billion rubles greater than the plan for 1962. Thus, with the change indicated by the mid-1961 increase, the differences between estimated and announced expenditures begin to disappear. (It is not being suggested, however, that GNR's estimates are so accurate that this explanation necessarily provides the answer -- certainly there are alternative explanations, including coincidence.)

#### Pricing Military Items

Implicit in the approach used by GNR is that the Soviet defense industries are on a *khozrachat* basis. There is, however, only limited evidence that such is the case. Certainly it is the usual practice in Soviet industry and there is evidence to this point with regard to the production of civil transport aircraft. Moreover, there is the rationale that it would probably be pointless for them to do otherwise for the defense industries.

Even granting the above, there is understatement in a "real" sense: in Soviet terms the allowances made for depreciation are low, particularly in light of obsolescence; in Western terms for the same reason and also because of rent and interest.

Although granting the above eliminates direct subsidization of military production, the problem still remains as it pertains to materials employed in the production of military items (and to such materials when directly consumed by the military establishment). The effect of such subsidies is

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not thought to be particularly significant, however, partially because of the relevant items so affected and partially, but more importantly, because of the relatively small element of the total cost of hardware accounted for by materials. Consequently, assuming khozrachet for the defense industries, increases in the costs of materials should not be expected to markedly affect the prices of most military hardware.

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